

NOTE 12 – BONDS AND NOTES PAYABLE – PRIMARY GOVERNMENT

A. General Information

General Obligation Bonds and Notes

Article 9, Section 15, of the State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. In addition, debt may be incurred without voter approval for the purpose of providing loans to school districts. General obligation notes to provide temporary financing for such loans are recorded as liabilities in the School Bond Loan Fund, a special revenue fund. General Fund appropriations are made to finance debt principal and interest requirements for all general obligation issues. General obligation bonds are backed by the full faith and credit of the State.

The State Constitution provides that the Legislature may also authorize the issuance of general obligation short-term notes, the principal amount of which may not exceed 15% of undedicated revenues received in the preceding year. The State Constitution also provides that such notes must be repaid within the fiscal year of the borrowing. In fiscal year 2004-2005, the State issued general obligation notes to meet cash flow requirements of the General Fund.

Short-term debt activity for the fiscal year ended September 30, 2005, was as follows (in billions):

	Beginning Balance	Draws	Repayments	Ending Balance
General Obligation Notes	\$ -	\$ 1.3	\$ 1.3	\$ -

Revenue Dedicated Bonds and Notes

Long-term bonds have been issued periodically for specific purposes, with the stipulation that financing of debt requirements is to come strictly from designated revenue sources. The transportation related debt is payable solely out of funds restricted for transportation purposes by Article 9, Section 9, of the State Constitution. The State's general credit does not support such issues.

In previous years, the Department of Transportation issued grant anticipation notes. The notes have variable rates that

may bear interest at a daily interest rate, a weekly rate, note interest term rate, long-term interest rate, or an ARS interest rate.

The notes are issued in accordance with the authorization provided in P.A. 51 of 1951, as amended. The proceeds of the sale of the notes, together with investment earnings on the proceeds and other available monies, will be used to pay a portion of the costs to complete the Build Michigan II highway program, to pay capitalized interest on the notes, and to pay note issuance costs.

The principal and interest on the notes are payable solely from and are secured by an irrevocable pledge of the State share of all federal grants received each year under the Federal-Aid Highway Program. Payment of the principal and interest on the notes from the State share shall be subject to an appropriation each year by the Legislature in an amount sufficient to make the payments. As of September 30, 2005, principal payments of \$428.0 million have been made on the notes. The amount outstanding at September 30, 2005, \$172.0 million, is not disclosed in the table below.

Revenue bonds have been issued by the State Building Authority (SBA) to acquire and/or construct various facilities for use by the State or institutions of higher education. Revenue bonds have also been issued to finance equipment capital lease refinancings and acquisitions. In addition, the SBA issues commercial paper notes to fund capital projects prior to bonding. Short-term debt activity for the fiscal year ended September 30, 2005, follows (in billions):

	Beginning Balance	Draws	Repayments	Ending Balance
Commercial Paper Notes	\$.4	\$ 2.8	\$ 2.9	\$.3

Note 13 provides disclosures regarding the bonds and notes payable of the discretely presented component units.

Bonds Issued and Outstanding

General obligation and revenue dedicated bonds issued and outstanding (excluding defeased bonds) at September 30 (in millions) are as follows:

	Amounts Issued	Outstanding 9/30/2005	Fiscal Year Maturities		Average Interest Rate Percentage
			First Year	Last Year	
General Obligation Bonded Debt					
General Obligation Refunding Debt:					
Series 2001 (Refunding)	\$ 183.3	\$ 171.2	2002	2016	4.76
Series 2002 (Refunding)	300.7	300.2	2004	2017	4.41
Series 2005 A (Refunding) (3)	86.8	86.8	2017	2021	5.00
Series 2005 B (Refunding) (3)	82.8	82.8	2013	2021	5.00
Series 2005 C (Refunding) (3)	21.1	21.1	2008	2013	4.17
Recreation and Environmental Protection:					
Series 1989 (1)	75.0	19.2	1991	2012	6.81
Series 1992 (1)	246.3	85.4	1994	2013	5.86
College Savings Bonds - Series 1992 Mini-bonds (1)	.5	1.1	2012	2012	6.50
Series 1992 A (1)(2)	13.9	6.5	1995	2013	6.17
Series 1993 (1)(2)	16.7	9.2	1996	2014	5.00
Series 1995 (1)	234.3	18.2	1997	2010	5.28
Series 1998 (1)	90.0	16.3	1999	2009	4.87

			Fiscal Year Maturities		Average Interest Rate
	Amounts Issued	Outstanding 9/30/2005	First Year	Last Year	Percentage
<u>State Building Authority:</u>					
1998 Series I Bonds (Refunding)	330.4	273.1	1999	2022	4.75
2000 Series I Bonds	147.9	128.9	2000	2022	5.24
2001 Series I Bonds (Refunding)	419.7	387.5	2003	2026	5.26
2002 Series III (Refunding)	215.2	205.1	2004	2027	4.56
2003 Series I (Refunding)	659.4	598.5	2004	2018	3.64
2003 Series II (Refunding)	392.6	386.5	2005	2030	4.42
2004 Series I	155.4	152.1	2005	2020	4.08
2005 Series I Multi Modal (4)	189.3	189.3	2006	2040	variable
2005 Series I (Refunding)	293.4	293.4	2006	2034	3.96
Total State Building Authority Bonded Debt	<u>2,803.3</u>	<u>2,614.5</u>			
Total Revenue Dedicated Bonded Debt	5,394.8	4,280.8			

Michigan
Notes to the Financial Statements

Total General Obligation and Revenue
Dedicated Bonded Debt

\$ 7,970.3 \$ 5,925.9

- (1) Public Acts 326 and 327 of 1988 and P.A. 451 of 1994 authorized the issuance of bonds totaling \$800.0 million. As of September 30, 2005, \$765.1 million of such bond proceeds had been received, leaving remaining authorization of \$34.9 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed, premiums and discounts, and other issuance costs.
- (2) The \$13.9 million Series 1992A and the \$16.7 million Series 1993, Recreation and Environmental Protection General Obligation Bonds, were used to provide a contribution of capital to the Michigan Municipal Bond Authority (a discretely presented component unit). An outside trustee for the Authority is holding the bonds as an investment of the Authority; no immediate cash proceeds were provided. The trustee receives the debt service payments on the bonds, which are negotiable instruments held to subsidize water pollution control financing provided by the Authority.
- (3) Public Act 284 of 1998 authorized the issuance of bonds totaling \$675.0 million. As of September 30, 2005, \$414.9 million of such bond proceeds had been received, leaving remaining authorization of \$260.1 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed, premiums and discounts, and other issuance costs.
- (4) The Multi-Modal Series, Environmental and School Loan Bond Series, currently bear interest at a commercial paper rate and are remarketed at each maturity. For the future debt service requirements, interest was estimated at the interest rate in effect at September 30, 2005.

- (5) In November 2002, voters approved a ballot proposal in which the State would issue \$1.0 billion in general obligations bonds to provide capital, which is then loaned to local units of government for water quality improvement projects. Rather than issuing the bonds at public or private sale and receiving cash, the State "issued" \$100.0 million in bonds to a discretely presented component unit, the Michigan Municipal Bond Authority (MMBA). Although no cash traded hands, MMBA (the registered owner of the bonds) is holding the bond document as collateral and issuing their own revenue bonds to generate the capital. This transaction allows the State's General Fund to defer principal and interest costs until future years when the bond is repurchased/redeemed. MMBA will fund the principal and interest costs of the revenue bonds until such time that they request the State to honor the general obligation bond document.

On December 18, 2003, the State issued \$100.0 million in bonds (\$10.0 million relating to Strategic Water Quality and \$90.0 million relating to the previously existing State Water Quality Revolving Fund). The \$10.0 million bond relating to Strategic Water Quality includes a repurchase provision that requires the State to repurchase all or any portion of this bond upon 10 days prior written notice from the registered owner, MMBA. The State anticipates at this time that if the bond repurchase was acted on, the State would issue long-term debt to finance the repurchase. This bond is being used as collateral by MMBA for the Strategic Water Quality bonds being issued by MMBA to local governments. For these reasons, the State has recognized the \$10.0 million bond related to Strategic Water Quality as a liability in the entity-wide statements. The \$90.0 million "bond" document issued for the State Water Quality Revolving Fund does not contain the 10 day repurchase provision that the \$10.0 million bond does. Nor is the \$90.0 million "bond" document being used as collateral by MMBA. For these reasons, the State has not recognized a liability for the \$90.0 million "bond" document related to the existing State Water Quality Revolving Fund.

Capital Appreciation Bonds

Capital appreciation and convertible capital appreciation bonds are recorded in the preceding table and Section B at their

accreted year-end book value. The table that follows summarizes capital appreciation bonds (in millions):

			Fiscal Year Maturities	
	Accreted Book Value	Ultimate Maturity Value	First Year	Last Year
General Obligation Bonds:				
Series 1989	\$ 19.2	\$ 23.6	1999	2012
Series 1992	15.7	20.0	2000	2012
College Savings Bonds - Series 1992 Mini-bonds	1.1	1.8	2012	2012
Series 1995	13.2	16.1	2001	2010
Revenue Dedicated – Transportation Related:				
State Trunkline – Series 1989 A	20.3	23.8	2004	2009
State Trunkline – Series 1992 A	67.8	84.9	2006	2013
State Trunkline – Series 1992 B	10.4	12.8	2006	2013

Michigan
Notes to the Financial Statements

Refundings and Defeasances

The State has defeased certain bonds through advance refundings by placing the proceeds of new bonds (i.e., the "refunding" bonds in the table of bonds issued and outstanding) in irrevocable trust to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded as assets or liabilities in these statements and are not included in the other debt tables in this note.

The State has defeased certain bonds through current refundings in which the proceeds of the refunding debt are applied immediately to redeem the debt to be refunded.

The State has defeased certain bonds by placing cash with an escrow agent in a trust to be used for future payment on the debt.

The following table summarizes the defeased bonds outstanding at September 30 (in millions):

	Amounts Outstanding
Recreation and Environmental Protection:	
Series 1995	\$ 157.5
Series 1998	50.4
Series 1999 A	56.1
Series 2000 (partial)	37.4
Series 2001	22.3
Series 2004 A	39.4
Series 2004 B	15.1
Total Recreation and Environmental	<u>\$ 378.2</u>
School Loan Bonds:	
Series 1995	\$ 103.3
Series 1998	69.1
Series 2001 C	45.9
Series 2002 A	30.9
Series 2002 B	46.5
Series 2003 B	3.3
Series 2004 A	203.2
Series 2004 B	25.4
Series 2004 C	22.0
Series 2005 A	59.2
Total School Loan Bonds	<u>\$ 608.7</u>
MUSTFA Related:	
Series 1996-1	\$ 104.8
Total MUSTFA Related	<u>\$ 104.8</u>
Comprehensive Transportation Fund Bonds:	
Series 2002 B (partial)	\$ 52.9
Series 2003	9.9
	<u>\$ 62.9</u>
State Trunkline Fund Bonds:	
Series 1996 A (partial)	\$ 45.2
Series 2001 A (partial)	245.8
Series 2004 (partial)	85.2
	<u>\$ 376.3</u>
Total Transportation Related	<u>\$ 439.2</u>
	Amounts Outstanding
State Building Authority:	
1994 Series II	\$ 11.7
1996 Series I	42.7
1997 Series I	70.3
1997 Series II	243.8
1998 Series I	75.2
1997 Series A	4.3
2000 (MSP Phase II)	31.1
2001 (MSP Phase III)	41.6
2002 (MSP Phase IV)	29.9
1991 Series I	61.9
2001 Series I	103.0
2001 Series II	150.1
Total State Building Authority	<u>\$ 865.6</u>

General Obligation

During the year, the State of Michigan issued \$190.7 million of General Obligation Bonds Series 2005 A, B, & C maturing in years 2008 through 2021 with fixed interest rates to advance refund four prior bond series. From the proceeds, \$22.3 million, was used to refund principal on General Obligation Series 2001, \$54.4 million was used to refund principal on General Obligation Series 1995, \$39.4 million was used to refund General Obligation Series 2004 A, \$15.1 million was used to refund General Obligation Series 2004 B, and \$59.5 million was deposited into the Combined Environmental Protection Bond Fund to fund environmental protection programs. As a result of these refundings, the State's debt service increased by \$2.7 million over the next 20 years. The State achieved an economic gain of \$5.3 million through these refundings.

Also during the year, the State of Michigan issued \$475.6 million of School Loan Multi-Modal Bonds Series 2005 B & C maturing in years 2008 through 2025 with a variable interest rate. The maximum interest rate applicable to the Series 2005 B is 15% annually and the maximum interest rate applicable to the Series 2005 C bonds is 12% annually. From the proceeds, \$436.3 million was used to refund principal on School Loan Bonds Series 2001 C, 2002 A, 2002 B, 2003 B, 2004 A, 2004 B, 2004 C, and 2005 A. \$39.3 million was deposited into the School Bond Loan Fund to make loans to local school districts.

The variable rate refunded and new debt bear interest rates based upon various periodic market rates and are remarketed at each maturity.

Revenue Dedicated

During the year, the State issued fixed rate State Trunk Line Refunding Bonds Series 2005 and 2005 B for \$601.3 million. The new bonds mature in years 2010 through 2023. The proceeds were used to refund \$146.5 million in outstanding principal on State Trunk Line Series 2001 A, \$85.2 million in outstanding principal on State Trunk Line Series 2004, and to retire \$400.0 million of Series 2001 Grant Anticipation Notes. As a result of these refundings, the State's debt service decreased by \$58.5 million over the next 27 years and the State achieved an economic gain of \$12.5 million.

Also during the year, the State issued fixed rate Comprehensive Transportation Refunding Bonds Series 2005 for \$62.2 million. The new bond matures in years 2009 and 2013 through 2023. The bond was issued to refund \$55.2 million in outstanding principal on Comprehensive Transportation Series 2002 B and \$9.9 million in outstanding principal on Comprehensive Transportation Series 2003. As a result of these refundings, the State's debt service decreased by \$2.5 million over the next 19 years and the State achieved an economic gain of \$2.4 million.

During the year, the State Building Authority (SBA) issued \$293.4 million of revenue refunding bonds to provide resources to purchase U.S. Government securities that were placed in an irrevocable trust, along with \$27.4 million of SBA cash and \$21.3 million of issuance premium, for the purpose of generating resources for all future debt service payments of \$315.0 million of bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the statement of net assets. The reacquisition price exceeded the net carrying amount of the old debt by \$17.6 million. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt. This advance refunding was undertaken to secure more favorable interest rates, reduce debt service payments during the first 13 years of the 28-year bond amortization, and produce an economic gain of \$24.4 million; however, if serviced serially through the maturity date of October 15, 2033, total payments under the refunding bond would exceed those of the refunded bonds by \$117.0 million.

Michigan
Notes to the Financial Statements

Debt Service Requirements

The following table summarizes debt service requirements for outstanding bonds (in millions):

Fiscal Years Ending	General Obligation			State Park, and Transportation Related		State Building Authority		Total Principal And Interest
	Principal	Fixed Interest	*Estimated Interest	Principal	Fixed Interest	Principal	Interest	
2006	\$ 56.4	\$ 54.1	\$ 16.7	\$ 49.5	\$ 77.8	\$ 82.1	\$ 132.9	\$ 469.5
2007	68.2	53.8	16.7	51.0	76.5	100.5	130.1	496.7
2008	77.5	50.8	16.7	64.7	74.8	105.1	125.3	514.8
2009	79.3	47.6	16.6	67.0	72.5	110.0	120.1	513.1
2010	85.1	44.1	16.6	99.8	69.9	115.5	114.5	545.5
2011-2015	493.0	150.8	82.3	505.6	283.2	666.1	475.1	2,656.0
2016-2020	417.8	45.1	76.3	555.2	148.6	589.8	298.8	2,131.5
2021-2025	370.2	1.8	30.4	289.4	27.2	370.4	181.8	1,271.2
2026-2030	-	-	-	7.2	.4	216.9	111.0	335.4
2031-2035	-	-	-	-	-	72.9	76.8	149.7
2036-2040	-	-	-	-	-	185.3	42.3	227.6
Thereafter	10.0	-	-	-	-	-	-	10.0
Total	<u>\$1,657.4</u>	<u>\$ 448.0</u>	<u>\$ 272.1</u>	<u>\$1,689.3</u>	<u>\$ 830.9</u>	<u>\$2,614.5</u>	<u>\$1,808.8</u>	<u>\$ 9,321.0</u>

*Interest for Multi-Modal Bonds future debt service requirements was estimated at the rate in effect at September 30, 2005.

Interest to maturity for the State Building Authority will be significantly smaller than the amount shown in the above table because many of the bonds will be called prior to the final scheduled maturity date. The retirement of these bonds varies from project to project, as each bond issue is related to specific projects and any excess borrowing and accrued investment earnings are restricted to projects and debt service on the related bonds. State Building Authority debt service fund unreserved

fund balances totaled \$193.6 million at year-end. Most of this represents investments related to completed projects that will be used for debt service on the projects' bonds.

Some of the bonds of the State Building Authority carry variable interest rates and interest on these has been projected using an average interest rate.

B. Changes in Bonds and Notes Payable

Changes in bonds and notes payable for the year ended September 30, 2005, are summarized as follows (in millions):

Governmental Activities	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
Bonds Payable:						
General obligation debt	\$ 1,527.5	\$ 750.8	\$ 633.3	\$ 1,645.1	\$ 56.4	\$ 1,588.7
Revenue bonds	1,443.1	669.8	446.7	1,666.3	49.5	1,616.8
State Building Authority	2,544.6	482.7	412.8	2,614.5	82.1	2,532.4
Notes Payable:						
Transportation related	600.0	-	428.0	172.0	-	172.0
Deferred Loss on Refundings:						
General obligation debt	(27.7)	(12.2)	2.6	(37.3)	-	(37.3)
Revenue dedicated debt	(13.2)	(21.0)	1.4	(32.8)	-	(32.8)
State Building Authority	(56.9)	(17.6)	7.5	(66.9)	-	(66.9)
Unamortized Premiums:						
General obligation debt	48.9	17.9	4.1	62.8	-	62.8
Revenue dedicated debt	46.2	58.6	4.1	100.8	-	100.8
State Building Authority	130.1	21.3	8.6	142.8	-	142.8
Total bonds and notes payable	<u>\$ 6,242.7</u>	<u>\$ 1,950.4</u>	<u>\$ 1,892.3</u>	<u>\$ 6,267.1</u>	<u>\$ 187.9</u>	<u>\$ 6,079.2</u>

Plus State Building Authority commercial paper notes reported as "Current Liabilities: Bonds and notes payable" on the Statement of Net Assets

As reported on the Statement of Net Assets

334.2	334.2	-
<u>\$ 6,601.3</u>	<u>\$ 522.1</u>	<u>\$ 6,079.2</u>